# MEMORANDUM

**TO:** **Chairman Charles E. Box**
**Commissioner Erin O'Connell-Diaz**
**Commissioner Lula Ford**
**Commissioner Sherman Elliott**
**Commissioner John Colgan**

**FROM:** **Eve Moran and Leslie Haynes, Administrative Law Judges**

**DATE:** **January 8, 2010**

**SUBJECT:** **North Shore Gas Company**

**Proposed general increase in natural gas rates. (Tariffs filed on February 25, 2009)**

**The Peoples Gas Light and Coke Company**

**Proposed general increase in natural gas rates. (Tariffs filed on February 25, 2009)**

## ALJs' Responses to Commission Questions

The mechanics of the Rider ICR Tariff (as modified by PGL's adoption of certain Staff recommendations) appears in Staff Exhibit 15.0, Attachment G. This document and the testimony of PGL witness Valerie Grace (Peoples Gas Exhibit VG 1.0 Rev.) is the record source of the ALJs' Responses to the Commission's questions put to us on January 6, 2010. We aim to be complete and accurate in these answers.

## I. Context for the Responses

The Rider ICR tariff is modeled on, but not identical to Qualifying Infrastructure Plant Surcharge, 83 Ill. Adm. Code Part 656 of the Commission's rules for water and sewer companies. Peoples Gas Ex. VG 1.0 Rev. at 35.

For easier reading of the Rider ICR tariff, we highlight the particulars:

1. The ICR Charge is to be billed over a 9-month period, i.e., April through December. Rider ICR tariff, Section B. The first charge would go into effect on April 1, 2011. Peoples Gas Ex. VG 1.0 Rev. at 35.

2. On or before March 20 of each year, PGL is required to file with the Commission an "Information Sheet" specifying the ICR percentage to be effective for service

rendered during the period of April 1 through December 31 of such year. Rider ICR Tariff at Section A. (Sample reports provided at Peoples Gas Ex. VG 1.14 set out what would be submitted to the Commission in years 2011, 2012 and 2113 and these reflect data from the cost-benefit analysis of Mr. Marano under the year 2030 completion date).

3. The cap is set out in Section C (a) of the Rider ICR tariff and states that: "The annual amount to be billed under Rider ICR shall not exceed the product of Annual ICR Rate Base Revenues multiplied by 5%."

4. The second Rider ICR filing and each filing thereafter will include a "reconciliation" adjustment that reconciles actual costs and revenues for the prior operation years. Staff recommended and PGL agreed to tariff language stating that PGL will file its petition for the initiation of an annual reconciliation hearing no later then March 31 of each year following the first Effective Period. See Section H (a) of the Rider ICR Tariff. PGL also agreed to include Staff's language that the Commission may require "a determination of whether all costs recovered under this rider were prudently incurred, just and reasonable." Id. In addition to adjustments, amounts either collected or refunded through the O component shall accrue interest at the rate established by the Commission under 83 Ill. Adm. Code 280.70(e)(1).

5. Under the Rider ICR tariff, PGL will file an "internal audit" report with the Commission no later than September 1 of each year that determines whether the ICR Charge Percentage and annual reconciliation determination for the prior reconciliation year have been calculated in accordance with the rider. Peoples Gas Ex. VG 1.0 Rev. at 37. The Company agreed to include language that sets out Staff's recommended list of particular "tests" for this audit. See ICR Tariff Section I.

6. The ALJs would have the Commission note that the PEPO accepts Staff's proposed 163 basis point downward adjustment for the ROE factor in the Rider ICR tariff. See ICR Tariff Section E and PEPO at 132.

## II. Response to Chairman Box - start of replacement cost recovery.

The short answer is that Rider ICR is not incremental. A fuller explanation follows.

Pursuant to Section D(a) of the Rider ICR Tariff,

> "Qualifying Infrastructure Plant" means such replacements of cast iron and ductile iron main and ancillary infrastructure as were not included in the calculation of the rate base of the Company's last rate case.

Section D(b) of the Rider ICR Tariff specifies that:

> QIP shall include only plant additions *installed* or *estimated to be installed* on or after January 1 of the year in which the Company files its initial ICR charge percentage. (Emphasis added).

What all of this tariff language sets out is that the amounts included in the calculation of Peoples Gas' rate base for this proceeding and the amounts associated with main replacements installed before the end of the test year (2010) are excluded. Under the tariff then, the earliest eligibility for rider recovery is replacement installed or estimated to be installed as of January 1, 2011. But that replacement is not incremental to anything and starts with the first dollar invested in 2011.

We recall it said at oral argument on January 5, 2010, that these particular rider features of no baseline arose out of a "Staff proposal" in the last PGL rate case. The final Order for Dockets 07-0241 and 07-0242 (Cons) confirms this as fact. See Order at 153, footnote 32 (which generally explains that while PGL originally had proposed a baseline for expenditures, it later "modified and accepted" a version of Staff's alternative Rider QIP proposal that had no baseline expenditure provisions). While that Order rejected Rider ICR, it did so for reasons unrelated to anything in the proposed tariff itself.

While it is difficult to grasp the nature and circumstances of other proceedings, we note that in the Nicor rate case, that the Utility's QIP Rider proposal included, among other things, cast iron main replacements that are above and beyond the first 15 miles of main replacement to be classified as QIP in any calendar year. Order at 168, Docket 08-0363 (March 25, 2009). The Order does not explain how Nicor arrived at this figure. Regardless, neither the AG nor Staff supported the QIP rider. The Commission rejected the rider largely on Nicor's failure to provide a showing consistent with the standards set out in the 2008 PGL/NS rate case Order.

Turning back to this case, there are no specific recommendations for changes to the Rider ICR Tariff language other than those coming from Staff. See pages 184-186 of the PEPO. In other words, while the AG criticized the tariff in some aspects (See PEPO at 155-156), it never proposed a baseline for ICR charges or specified on what basis the baseline should be developed. Neither did Staff or any other party. The record is silent. Nevertheless, the Commission may find it useful to consider that the rebuttal testimony of PGL witness Doerk indicates that Peoples Gas currently forecasts replacing about 20 miles of cast iron main in 2009 at a total capital cost of $22 million. NS-PGL Ex. ED-2.0 at 5. Further, Peoples Gas currently forecasts replacing about 10 miles of cast iron main in 2010 at a total capital cost of 11.5 million. Id.

## III. Response to Commissioner Colgan – the kind of costs recoverable.

While the short answer would be "forecasted costs" this is not altogether a complete response as seen below.

Under Section "B" of Rider ICR, "QIP Costs" mean Qualifying Infrastructure Plant costs recoverable through the Infrastructure Cost Recovery ("ICR") Charge as determined in accordance with Section F of the rider.

For determining the ICR Charge Percentage, the formula set out in "Section F" of the Rider ICR tariff provides this description of the OQIP (Operational Year Qualifying Infrastructure Plant) input:

> For accounts 376 (distribution mains), 378 (measuring & regulating station equipment, general), 379 (measuring & regulating station equipment, City Gate) and 380 (services), the average forecasted cost of the investment on QIP, less forecasted retirements, less forecasted accumulated depreciation, shall be computed by using an average of the balances of QIP, retirements and accumulated depreciation for December 31 of the year preceding the Operation Year and December 31 of the Operation Year.
>
> For accounts 381 and 383, the average forecasted cost of the investment in QIP less retirements, less forecasted accumulated depreciation, all multiplied times the applicable QIP percent. The average forecasted cost of QIP, net of retirements and accumulated depreciation, shall be computed by using an average of the balances of QIP, retirements and accumulated depreciation for December 31, of the year preceding the Operation Year and December 31 of the Operation Year.

Ms. Grace explained that the QIP input to be reflected in the determination of the ICR percentage for Account Nos. 381 and 383 will be based on forecasted investments that will be determined by applying specific percentages to the estimated total costs of purchased meters and regulators. Peoples Gas Ex. VG 1.0 Rev. at 36. This percentage was later modified on agreement with Staff. See Tariff, Section "B." Ms. Grace further testified that the calculation on the ICR Charge Percentage will include an offset for estimated savings. See Tariff, Section "F."

## IV. Record Information for "Conditioning" Rider ICR.

If the Commission is interested in types of conditions that would attach to an approval of Rider ICR, we direct its attention to certain testimony on record. Mr. Marano states, at page 77 of his revised direct testimony, that:

> If approval for Rider ICR is granted, allowing the accelerated main replacement to proceed, PGL will commit to providing Commission Staff annually with a detailed report showing the progress and plans for its accelerated replacement program. The flow of reduced system operations and maintenance costs to customers, when achieved, will be

> apparent in the annual reconciliation process. Peoples Gas Ex. SDM-1.0 Rev. at 77 (Emphasis added).

This testimonial account supports our view that a formal docketed proceeding is not necessary to achieve the end of having the Company accelerate main replacement in the best possible way.[1] For example, the Commission can require Staff and the Company to work together in order to develop a suitable framework for the particulars of such a "detailed report" and agree on the date for its annual submission. This might be preceded by an informal "workshop-type" meeting between Staff and Peoples Gas at which Jacobs Consultancy would provide a walk-through of the implementation plan that is on record and answer questions, the Company could explain what steps would follow, and Staff could better assess what information it wanted to see in the detailed report. This meeting should be open to interested parties and particularly the City.

For its Order too, the Commission can specify the extent of the pace and progress it wants to see happen (e.g. to approximate Mr. Marano's 2030 plan). The Commission might reasonably provide that if any exigent circumstances arise, or if certain flexibility is needed, the Company is required to provide Staff with a documented showing in support of the situation. Finally, while the Company is presumed to act in good faith, the Commission can certainly state that a failure to produce a satisfactory report, or to execute the acceleration in reasonable compliance therewith, will be brought to the attention of the Commission for action that may include a Section 8-503 proceeding.

[1] As seen in Part I of this memo, by virtue of the tariff provisions requiring the annual filings of an information sheet, annual audits and annual reconciliations, all of the Rider ICR costs, replacement work, and the pace of progress will be both transparent and subject to scrutiny.